Supreme Court, U.S.
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ALEXANDER L. STEVAS,
CLERK

83-1088

CASE NO.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1983

IN THE MATTER OF TOP TILE BUILDING SUPPLY CORPORATION, TOP CARPET CORPORATION, NORMAN L. STONE and RICHARD STONE,

Appellants,

-against-

NEW YORK STATE TAX COMMISSION; NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES H. TULLY, JR., MILTON KOERNER, THOMAS H. LYNCH, INDIVIDUALLY AND AS MEMBERS OF THE STATE TAX COMMISSION,

Respondents.

PROCEEDING UNDER ARTICLE 78 OF THE NEW YORK CIVIL PRACTICE LAW AND RULES TO ANNUL A SALES TAX ASSESSMENT. ON APPEAL FROM THE SUPREME COURT OF ALBANY COUNTY, STATE OF NEW YORK.

JURISDICTIONAL STATEMENT.

COUNSEL OF RECORD FOR PETITIONERS:
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SUPREME COURT OF THE UNITED STATES

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In the Matter of TOP TILE BUILDING SUPPLY CORPORATION, TOP CARPET CORPORATION, NORMAN L. STONE and RICHARD STONE,

Appellants,

-against-

NEW YORK STATE TAX COMMISSION; NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES H. TULLY, JR., MILTON KOERNER, THOMAS H. LYNCH, individually and as members of the State Tax Commission,

Respondents.

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# JURISDICTIONAL STATEMENT

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## QUESTIONS PRESENTED

1. Section 1138(a)(4) of the New York Tax Law requires that an individual, whom the New York State Tax Commission has determined to be personally liable for the sales taxes of a business organization

carried on in corporate form, make a cash deposit or file an undertaking in the amount of those sales taxes in order to obtain court review of the Tax Commission's determination. Is this section unconstitutional in that it deprives the individual of property without due process of law and denies the individual the equal protection of the laws in violation of the 14th Amendment of the United States Constitution?

2. Same question, with the fact added that the State Tax Commission, without explanation or justification, deliberately refused to produce one of its own employees who was a key witness, to testify and be cross-examined under oath at the State Tax Commission hearing which resulted in the above-described determination.

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## OPINIONS BELOW

Opinions not officially or unofficially reported (apparently), but included in the Appendix hereto.

## JURISDICTIONAL GROUNDS

This proceeding was timely brought under Article 78 of the New York Civil Practice Law and Rules for a judgment annulling a determination of the New York State Tax Commission in a sales tax matter.

The judgment sought to be reviewed was entered September 29, 1983 and notices of appeal were filed in the Supreme Court of the State of New York, Albany County, and the Appellate Division of the Supreme Court of the State of New York, Third Department on December 23, 1983. This Court is believed to have jurisdiction of this appeal pursuant to Title 28, United States Code, Section 1257(2).

## CONSTITUTIONAL PROVISIONS

This case involves Section 1 of the Fourteenth Amendment to the U.S. Constitution, which reads as pertinent: "...nor shall any State deprive any person of...property, without due process of law;...".

## STATEMENT OF CASE

In 1973, the New York State Tax Commission issued a wholly-fictitious sales tax assessment against petitioners, based not on any audit but on an arbitrary increase of exactly 20% over and above the amount of sales tax previously reported and paid by petitioner. The only justification for this wholly-fictitious assessment was the alleged failure of petitioners to cooperate with an auditor who, in 1969 or 1970, had begun but never finished an audit at petitioners' New York City office. Thereafter, and long after the period of limitation for the assessment of sales tax deficiencies had expired, an actual audit took place and in 1976 an actual assessment was issued. Petitioners thereupon applied for a hearing before the State Tax Commission.

At the hearing, held in 1980, petitioners Norman L. Stone and Richard Stone, president and treasurer, respec-

tively, of petitioner Top Tile Building Supply Corp. (Top Tile) testified at great length, under oath, that they had cooperated 1,000% with respondents' auditor, giving him a desk and office space to use and assigning a bookkeeper to assist him and informing him that he was free to come and go during business hours, namely 9:00 AM to 5:00 P.M., with or without appointment. Petitioners' officers also testified that this auditor spent a great deal of time at petitioners' office, but that his appearances became less and less frequent. He complained that he was simultaneously conducting numerous other audits, and eventually he abandoned the audit of petitioners' sales tax records altogether.

However, the State Tax Commission, despite repeated requests before during and after the hearing, refused to produce the aforesaid auditor to testify and be cross-examined at the hearing. Instead,

another auditor, unfamiliar with the case, who claimed to have spoken on the telephone to the aforesaid auditor, was put on the stand and testified that petitioners had not cooperated with the aforesaid auditor. When questioned about this, however, this other auditor turned aside all questions by claiming a lack of familiarity with the details.

In 1981 a determination was made by the State Tax Commission that petitioners owed approximately $34,000 in sales taxes for the years in question, 1968-1973, together with interest and penalties of approximately $58,000 for a total of $92,000. Petitioners thereafter commenced a proceeding in the Supreme Court of the State of New York in the nature of certiorari and prohibition, pursuant to Article 78 of the New York Civil Practice Law and Rules, to annul this determination. But they did not make a cash

deposit or file an undertaking with the court in the amount of the taxes interest and penalties allegedly owed, as required by §1138(a)(4) of the New York Tax Law as a precondition to court review of sales tax determinations of the State Tax Commission. The petition alleged that the deposit or undertaking requirement was unconstitutional under the 14th Amendment of the U.S. Constitution. The Supreme Court of the State of New York dismissed the petition for failure to comply with the deposit or undertaking requirement, and this judgment was affirmed by the Appellate Division, Third Department, which held that the cash deposit or undertaking requirement was constitutional. The New York Court of Appeals dismissed petitioners' subsequent appeal from the order of the Appellate Division, and judgment dismissing the petition was thereafter entered on September 29, 1983

in the Supreme Court of the State of New York.

STATEMENT OF REASONS

1. Petitioner Top Tile was at the time in question a New York corporation in the business of marketing home repair and improvement products at retail stores in New York State and Massachusetts. Petitioners Norman L. Stone and Richard Stone were officers of petitioner Top Tile considered to be personally liable for sales taxes of the vendor Top Tile because of their responsibilities, which included sales tax compliance. New York Tax Law §1131 and §1133. The petition alleges that since Norman L. Stone and Richard Stone do not have an excellent or "triple A" credit rating they would have to post cash in the amount of $92,000 to comply with the deposit or undertaking requirement of §1138(a)(4) of the New York Tax

Law. This would be an astronomical amount for petitioners Norman L. Stone and Richard Stone, and it bears no rational relationship to the income or property of these petitioners. This is because the basis for the sales taxes claimed to be due from the individual petitioners herein is not the income received or the property owned by them but rather the gross receipts of a chain of retail stores.

The cases cited in the opinions of the New York courts hold that §1138(a)(4) of the Tax Law is constitutional on its face. Matter of Driscoll v. State Tax Comm. (S.C. Albany 1980, October 28, 1980, Klein, J. affd. 86 A.D.2d 721, app. dsmd. 56 N.Y.2d 644, and see Western Elec. Co. v. Taylor, 1276 N.Y. 309 (1938), Matter of Hochman v. State Tax Comm., 68 M.2d 781 (S.C. Albany, 1971). None of these decisions contains an extended discussion of this issue, however. Federal cases

have also considered the use of such procedures. Phillips v. Commissioner, 283 U.S. 589 (1930); Flora v. United States, 357 U.S. 63 (1958) and 362 U.S. 145 (1960), and Dodge v. Osborne, 240 U.S. 118 (1916). But the hardship or financial burden imposed on the taxpayers in Phillips, Flora and Dodge was not comparable to that involved in the present case. Those cases involved the Federal income tax, the basis of which is, of course, the taxpayer's own income. In fact in Flora the court noted that if summary procedures were extended from income taxes to excise taxes, since excise taxes may be divisible into a tax on each transaction "...the full payment rule would probably require no more than payment of a small amount". Flora, supra, page 175, footnote 38. See also Steele v. U.S., 280 F.2d 89 (8th Cir. 1960). By contrast, the basis of the sales tax assessment herein, as noted, was not the

income of a single individual for a quarterly payroll period or even for one full year, but rather the gross receipts of a chain of retail stores over a period of six years. This could be a huge sum in relation to the cash flow and assets of one single individual, so it is plain to see why the New York Court of Appeals has described the deposit or undertaking requirement of §1138 of the Tax Law as an "...exacting prerequisite to judicial review..." Parsons v. State Tax Comm., 34 N.Y.2d 190, 197 (1974). In the instant case, as noted, petitioners would have had to obtain cash or similar assets in the amount of $92,000.

Finally, further note should be taken of Phillips v. Commissioner, supra, in which this Court addressed at length and specifically the due process standards applicable in tax cases. In an opinion by Mr. Justice Brandeis, the court made the

following observations regarding due process of law and summary tax collection procedures:

> "The procedure provided in section 280(a)(1) satisfies the requirements of due process because two alternative methods of eventual judicial review are available to the transferee. (He may either pay the tax and sue for a refund or seek a redetermination before the Board of Tax Appeals [now the Tax Court] without first paying the tax. In the latter case) ...there is a complete hearing de novo according to the rules of evidence applicable in courts of equity of the District of Columbia. A review by the Circuit Court of Appeals of an adverse determination may be had; and assessment and collection may be stayed by giving a bond to secure payment." Page 599. (Bracket added).

The Phillips court also noted:

> "Where only property rights are involved, mere postponement of the judicial inquiry is not a denial of due process if the opportunity for the ultimate judicial determination of the liability is adequate." (Phillips, supra, pages 596-597, underlining added).

In this connection it is noteworthy that in Phillips, court review was available without a bond, although one was required

to stay collection of the taxes. Phillips, supra, page 599.

Therefore, in petitioners' view, it is by no means clear that deposit or undertaking requirements are never constitutionally suspect on their face. In fact one New York case actually implied that the sales tax review bond itself might be unconstitutional if the tax were confiscatory or so large as to preclude the possibility of an appeal. Gordon v. Gerosa, 16 M.2d 710 (S.C.N.Y. 1959). Another New York decision squarely holds to this effect, in a case involving New York City cigarette tax assessments from which appeals could only be taken if a cash deposit or bond exactly similar to the bond required in New York State sales tax appeals was first posted. Sea Lar Trading Co., Inc. v. Michael, 107 M.2d 93, 100 (S.C.N.Y. 1980). The court said:

"The imposition of this condition of full payment of the tax, prior to the allowance of judicial review of the propriety of the determination after hearing, is tantamount to the preclusion of the right to due process.

"The rights of respondent to collect its taxes are maintained by his power to levy and seize assets; the requirement of full payment before resort may be had to the courts does not serve any further governmental interests.

"Since the only method open to petitioner to review this tax determination is through a proceeding in our courts, due process requires that this not be unduly burdened. (See Bodie v. Connecticut, 401 U.S. 371; cf. Lindsey v. Normet, 405 U.S. 56, 74-79.)" Page 100.

2. The original petition herein dated February 26, 1982 fully sets forth facts showing that the State Tax Commission hearing in this case was unfair and in contravention of due process of law.* This petition, as noted, alleges initially that the State Tax Commission made use of

* Only the original petition is considered in this Jurisdictional Statement.

a wholly-fictitious assessment, arbitrarily increasing petitioners' sales taxes by 20%, and used it to hold open the statute of limitations until an audit-based assessment could be made. Such wholly-fictitious assessments to extend the statute of limitations have been declared illegal. Brown v. State Tax Commission, 304 N.Y. 651 (1952) and see Slater v. Gallman, 38 N.Y.2d 1 (1975).

The State Tax Commission, however, sought to justify the use of this arbitrary assessment by falsely claiming that petitioners had refused to cooperate with one of their auditors. Consequently the crucial issue before the State Tax Commission was the issue of cooperation, and on this issue the hearing process was manipulated to produce the result desired by the State Tax Commission.

The express language of the original petition regarding this issue was as

follows:

"14. Pursuant to law, a hearing was held and evidence taken before respondents on January 31-February 1, 1980, after a petition was duly filed by petitioners herein, and a determination was thereafter made by respondents dated October 23, 1981, that petitioners owed $91,920 in taxes, including interest and penalties through December 14, 1981. Said determination, however, is not supported by substantial evidence on the entire record. Specifically, respondents' determination that petitioners had failed to cooperate with respondents' auditors was made as the result of arbitrary and capricious rules of evidence enforced by respondent State Tax Commission which rewarded respondent Department of Taxation and Finance for suppressing important material and decisive evidence and concealing the truth regarding petitioners' cooperation with respondents' auditors. Specifically, respondents refused to allow the auditor petitioners were accused of not cooperating with to testify at the aforesaid hearing.

"15. This determination of respondents upheld so-called estimated assessments made against petitioners in 1973 although said assessments were made illegally for the purpose of extending the statute of limitations and were nullities. This determination of respondents further upheld assessments made against petitioners in 1976 which were made illegally because barred

> by the statute of limitations. In upholding these assessments respondents were acting illegally and unconstitutionally and without authorization by the Tax Law of New York or any other statute or law. (Underlining added.)"

In the Grounds for Relief of this petition, the following language appears:

> "1. Petitioners claim the deposit and/or undertaking requirement of Section 1138 of the Tax Law of New York is unconstitutionally burdensome and discriminatory." (Underlining added.)

This portion of the gravamen and the grounds for relief in the original petition sufficiently alleges the unconstitutional deprivation of property. It is the combined effect of the unfair hearing and the undertaking requirement of §1138 of the Tax Law that petitioners are protesting. Such a combination of obstacles was held to violate due process of law by the Supreme Court of California in Brooks v. Small Claims Court of Los Angeles, 504 P.2d 1249 (S.C. Calif. 1973). That court

held:

> "...it is manifest that the requirement of an undertaking in connection with an appeal from a judgment entered in a small claims court constitutes a taking of property prior to a due process hearing..." P. 1253. (Emphasis added.)

To the same effect, see Bodie v. Connecticut, 401 U.S. 371 (1971).

This is a logical extension of the general rule of appellate rights, set out as follows in Ohio v. Akron Park District, 281 U.S. 74 (1929):

> "As to the due process clause of the Fourteenth Amendment, it is sufficient to say that, as frequently determined by this Court, the right of appeal is not essential to due process, provided that due process has already been accorded in the tribunal of first instance." P. 80. (Emphasis added.)

The hearing afforded petitioners herein by the State Tax Commission involved a transparent, uniformly condemned violation of due process of law, namely denial of the right to confront an adverse

witness. This Court has repeatedly described this right as an immutable principle of our jurisprudence. Greene v. McElroy, 360 U.S. 474 (1958), Goldberg v. Kelly, 397 U.S. 254 (1970), Jenkins v. McKeithin, 395 U.S. 411 (1968) and Willner v. Committee on Character and Fitness, 373 U.S. 96 (1963).

The grounds for relief on the original petition also contained the following statement:

> "4. Petitioners further claim the aforesaid civil fines or penalties of approximately $17,500 are unconstitutional, as set forth above, and that in seeking to collect them, respondents are proceeding without or in excess of jurisdiction, and to enforce a determination that was arbitrary and capricious, all in violation of petitioners' constitutional rights as set forth above, pursuant to Section 7803, subdivisions 2 and 3 of the Civil Practice Law and Rules."

It is an established rule that on a motion to dismiss, pleadings are to be liberally construed. Barber v. Rowe, 235 N.Y. 549.

And the facts alleged are to be deemed admitted and must be considered in the light most favorable to the pleader. Semple v. Miller, 38 A.D.2d 174 (4th Dept. 1972). This approach certainly seems warranted in Article 78 proceedings which must be brought within 4 months of the making of the challenged determination, very short notice. Section 217 New York Civil Practice Law and Rules. Viewed from this perspective, the petition clearly alleges facts constituting a violation of procedural due process of law.

The very basis of the concept of procedural due process of law is a reasonable opportunity for a fair hearing, and the petition gives respondents ample notice of petitioners' claim that the State Tax Commission hearing was procedurally flawed and that therefore the deposit and/or undertaking requirement of §1138 of the Tax Law is "unconstitutionally burdensome

and discriminatory." (Grounds for relief, petition, quoted above.) Petitioners believe the Appellate Division should not have converted this Article 78 proceeding into a declaratory judgment action, since the original petition adequately informed the respondents of petitioners claim that the unfair procedures followed by the State Tax Commission violated petitioners' constitutional rights. Petitioners therefore request this Court to find that it has power to review the constitutional issue herein, if deemed substantial.

Petitioners believe the constitutional question is worthy of this Court's attention. To explain; §1138 of the Tax Law imposing the preliminary requirement of a cash deposit or undertaking as a precondition to judicial review was enacted in 1965, effective April 10, 1967. L.1965, ch. 33, §1. This financial obstacle to appellate review has been described as an

"exacting prerequisite" by this Court (Parsons v. State Tax Commission, 34 N.Y. 2d 190 (1974) and as pointed out by one New York lower court, is not essential to the governmental interest because judicial review in itself does not prevent the State Tax Commission from pursuing its collection efforts. Sea Lar Trading Co. v. Michael, 107 M.2d 93 (S.C.N.Y. 1980). In fact in personal income and corporate franchise tax cases the legislature dropped the appeal bond requirement 20 years ago, and today judicial review of these taxes is available without a cash deposit or undertaking, although one or the other must be posted to stay collection of the tax. See New York Tax Law Sections 690(a) and 1090(a), (and former Sections 200 and 375).

More significantly, ten years after §1138 of the Tax Law was enacted, the State Administrative Procedure Act,

guaranteeing a fair hearing with the right of cross examination, was enacted. McKinneys New York Session Laws, L.1975, ch. 167, effective September 1, 1976. It is the passage of this law, applicable to the State Tax Commission (see National Elevator Ind. v. State Tax Commission, 49 N.Y.2d 538, 546-547, 1980) that creates the present controversy.

Petitioners' main argument is that state law may create property rights protected by the due process clauses of the state and federal constitutions, and that the State Administrative Procedure Act, guaranteeing an evidentiary hearing with the right to hear and cross examine adverse witnesses, is an example of such a law. This aspect of petitioners' argument goes back to the original intendment of the idea of due process of law, as described in an early decision of this Court, Davidson v. New Orleans, 96 U.S. 97 (1877)

as follows:

> "It is easy to see that when the great barons of England wrung from King John, at the point of the sword, the concession that neither their lives nor their property should be disposed of by the crown, except as provided by the law of the land, they meant by 'law of the land' the ancient and customary laws of the English people, or laws enacted by the Parliament of which those barons were a controlling element." Page 102. (Emphasis added.)

This earlier opinion then goes on to describe the evolution of due process of law into a restriction on legislative as well as executive power. Davidson, supra, page 102. But the quoted portion makes clear the importance of the legislative role in formulating due process of law standards. This is the basis of petitioners belief that the New York State legislature has formulated a due process of law standard by guaranteeing a fair hearing to vendors prior to payment of additional sales taxes.

Such a fair hearing is, without a

doubt, guaranteed by §1138 of the New York Tax Law and by Article 3, particularly §306(3), of the New York State Administrative Procedure Act, applicable to the State Tax Commission. See National Elevator Ind. v. State Tax Commission, supra. The legislative intent of the State Administrative Procedure Act provides:

> "The legislature hereby finds and declares that the administrative... adjudicatory...processes among the agencies of state government are inconsistent, lack uniformity and create misunderstanding by the public.
>
> "It is further found that in the public interest it is desirable for state agencies to meet the requirements imposed by the administrative procedure act. Those agencies which will not have to conform to this act have been exempted from the act, either specifically by name or impliedly by definition." Section 100.

The Governor's Memorandum accompanying the new law also states:

> "The Act establishes uniform notice requirements to assure that any person will have an adequate opportunity to be heard, and it

> also prescribes standards of evidence for hearings." (Emphasis added.)

* * *

> "But the time has come for New York to acknowledge and accept the principle that the agencies of government must respond to the needs of the governed, not only substantively, but procedurally." (Emphasis added.)

In view of these clear expressions of New York State tax, fiscal and administrative policy, the State Tax Commission should not be allowed to justify its non-observance of the law guaranteeing petitioners herein a fair hearing on the grounds that a fair hearing may be dispensed with in view of the need to collect taxes as expeditiously as possible. The state legislature and not the State Tax Commission determines the tax, fiscal and administrative policies of New York State, and the state legislature has rejected this hard-line approach in all but jeopardy assessment cases. §1138(b) New

York Tax Law; Parsons v. State Tax Commission, 34 N.Y.2d 190 (1974); and see Article XVI, Section 1, Constitution of New York State.

More recent cases have expanded on this view. Hewitt v. Helms, 51 U.S. Law Week 4124, decided by this Court February 22, 1983, notes that ordinarily prison inmates are not entitled to a hearing prior to transfer from one type of detention to another, for example from the general prison population to more restrictive confinement, provided the latter type of confinement could be deemed encompassed by the inmate's original prison sentence. See Meachum v. Fano, 427 U.S. 215, 225 (1976). According to the opinion in the Hewitt case, courts are chary about subjecting prison administration to judicial oversight. This reluctance parallels the reluctance of courts to subject the administration of the tax laws to

judicial oversight. See Bull v. United States, 295 U.S. 247 (1935). (But while the authorities state that peremptory measures may be used to collect taxes, they add the qualification that laws providing for such peremptory measures must be strictly complied with, or the proceedings will be invalid. Corpus Juris Secundum, volume 85, section 686, page 1365; Cooley, "The Law of Taxation", op. cit., page 2619.)

However, in the Hewitt case, Pennsylvania state law, by mandatory language, gave hearing rights to inmates in connection with important decisions (such as transfers to more restrictive confinement) as opposed to routine decisions dealing with day to day prison operations. This Court expressed the view that this state law, providing mandatory hearing rights in such cases, gave rise to an interest in "liberty" protected by the due process clause.

This Court has often ruled that state law may create property interests protected by due process as well as liberty interests. Goss v. Lopez, 419 U.S. 565, 572-573 (1974) and Board of Regents v. Roth, 408 U.S. 564, 577 (1972). And it has to a degree rejected the historical distinction between personal liberty and property rights, which relegated the latter to a significantly inferior degree of constitutional protection. Lynch v. Household Finance, 405 U.S. 538, 552 (1970). (Arguably an injust taking of property amounts to a sentencing after the fact to forced labor equal in value to the cost of creating or acquiring the property.)

The Hewitt case, in light of the holding in the Lynch case that both "property" and "liberty" are important personal rights protected by due process of law, justifies the inference that state law may also create an entitlement to a

due process hearing as an adjunct to property rights as well as to liberty. This is petitioners' argument. In other words the guarantees of a fair hearing with the right of confrontation, contained in the State Administrative Procedure Act, and applicable to the State Tax Commission, supersede the cash deposit or undertaking requirement of §1138 of the Tax Law. Otherwise these §1138 requirements would render the State Tax Commission, unlike other agencies of state government, effectively immune from the fair hearing guarantees of the later-enacted State Administrative Procedure Act. Petitioners believe the issue of whether these fair hearing guarantees rise to the level of constitutionally-protected rights under the Hewitt case, supra, is a substantial issue for this Court's consideration.

## CONCLUSION

Wherefore petitioners respectfully request plenary consideration of their case by this Court.

Respectfully submitted,

LORENTZ W. HANSEN
Counsel of Record

Dated: December 26, 1983
White Plains, New York 10601

## APPENDIX

STATE OF NEW YORK
SUPREME COURT : COUNTY OF ALBANY

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IN THE MATTER OF TOP TILE BUILDING SUPPLY CORP., TOP CARPET CORP., NORMAN L. STONE, RICHARD STONE,

Petitioners,

-against-

NEW YORK STATE TAX COMMISSION; NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES H. TULLY, JR., MILTON KOERNER, THOMAS H. LYNCH, INDIVIDUALLY AND AS COMMISSIONERS OF THE STATE TAX COMMISSION,

Resspondents.

FOR A JUDGMENT PURSUANT TO ARTICLE 78 OF THE CIVIL PRACTICE LAW AND RULES.

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(Supreme Court, Albany County Special Term, April 16, 1982. Calendar No. 33)

(JUSTICE GEORGE L. COBB PRESIDING)

APPEARANCES:

Lorentz W. Hansen, for petitioners.

Robert Abrams, Attorney-General (Frank Dow of counsel), for respondents.

COBB, J.

In this article 78 proceeding, wherein the petitioners seek judicial review of the State Tax Commission's determination of October 23, 1981 which upheld, in part, and modified, in part, certain notices of determination of additional sales and use taxes said to be due

from petitioners, respondents move pursuant to CPLR 7804 (subd. [f]) to dismiss the instant proceeding upon the ground that it was not commenced within the four-month period described in CPLR 217 and section 1138 of the Tax Law and upon the further ground that the petitioners have failed to file the bond or deposit of the "amount of any tax sought to be reviewed" as demanded by section 1138 (subd. [a], par. 4) of the Tax Law.

Since it appears that the petitioners neither deposited the amount of tax at issue herein nor posted an appropriate undertaking as demanded by section 1138 (subd. [a], par. 4) of the Tax Law, this court lacks jurisdiction to entertain the instant proceeding and dismissal must be ordered whether or not it was timely instituted (Matter of J. C. Penney Co. v. New York State Tax Comm., 86 A D 2d 705). Accordingly, the dismissal motion will be granted.

Submit order on notice.

Dated: August 6, 1982

All papers to attorney for respondents.

Supreme Court—Appellate Division
Third Judicial Department

May 12, 1983 44363

In the Matter of TOP TILE BUILDING SUPPLY CORP. et al., Appellants,
v.
NEW YORK STATE TAX COMMISSION et al., Respondents.

Appeal from a judgment of the Supreme Court at Special Term (Cobb, J.), entered September 20, 1982 in Albany County, which dismissed petitioners' application, in a proceeding pursuant to CPLR article 78, to annul a determination of the New York State Tax Commission which upheld in part and modified in part notices of determination of additional sales and use taxes due.

Following a formal hearing, respondents modified in part (in petitioners' favor) notices of determinations and demands for payment of sales and use taxes due, and as modified, denied applications for revisions. Respondents' determination was made October 23, 1981 and, as appears from an affidavit in the record, the determination was served upon petitioners by certified mail sent the same day. These proceedings were commenced by service of a notice of petition and verified petition on February 26, 1982. Petitioners did not deposit the tax, penalty and interest due nor did they file an undertaking (Tax Law, § 1138, subd. [a], par. [4]). Special Term held that these omissions deprived the court of jurisdiction and dismissed the petition without reaching the issue of the timeliness of the proceeding.

Initially, we note that Special Term failed to address itself to those aspects of the petition which first attacked the constitutionality of section 1138 (subd. [a], par. [4]) of the Tax Law and, in the amended petition, alleged violation of due process in the manner respondents construed the statute. The court limited its decision to finding that failure to pay the tax at issue or post an undertaking deprived the court of jurisdiction. While an article 78 proceeding is generally the proper vehicle to determine whether a statute, ordinance or regulation has been applied in an unconstitutional manner (Matter of Overhill Bldg. Co. v. Delany, 28 N Y 2d 449, 458), the rule is different when the issue is the constitutionality of legislative action (Matter of Kovarsky v. Housing & Development Admin. of City of N. Y., 31 N Y 2d 184, 191). It has consistently been held that a proceeding under article 78 is not the proper vehicle to test the constitutionality of legislative enactments (Press v. County of Monroe, 50 N Y 2d 695,

702). However, this court may, and, in reliance on CPLR 103 (subd. [c]), does hereby remedy the procedural infirmity by converting the article 78 proceeding to a declaratory judgment action and thereupon reach the merits (Matter of Ames Volkswagen v. State Tax Comm., 47 N Y 2d 345). In our analysis, we find that this court has held that payment of the tax imposed and the filing of an undertaking are conditions precedent to the maintenance of judicial review of Tax Commission determinations and that non-compliance deprives the court of jurisdiction (Matter of J.C. Penney Co. v. New York State Tax Comm., 86 A D 2d 705, mot. for lv. to app. den. 56 N Y 2d 507; Matter of Cooper v. Tully, 79 A D 2d 757). Petitioners, in attempting to distinguish these two cases, contend that no constitutional issue appears to have been raised properly in either case. However, in Matter of O'Driscoll v. State Tax Comm. (Supreme Ct., Albany County, October 28, 1980, KLEIN, J., affd. 86 A D 2d 721, app. dsmd. 56 N Y 2d 644), the constitutionality of the statute was squarely before the court and was upheld (see Matter of Western Electric Co. v. Taylor, 276 N. Y. 309; Matter of Hochman v. State Tax Comm., 68 Misc 2d 781). Since it is conceded that petitioner has failed to comply with statutory requirements, there can be no judicial review.

Petitioner's remaining arguments directed to the validity of the assessment, the hearing, the determination itself, and the timeliness of these proceedings, need not be reached.

Judgment modified, on the law, by adding thereto a provision declaring that the deposit and undertaking requirements of section 1138 (subd. [a], par. [4]) of the Tax Law are constitutional, and, as so modified, affirmed, with costs to respondents.

MAHONEY, P.J., SWEENEY, KANE, CASEY and WEISS, JJ., concur.

A. Franklin
Michael E.
T. Paul
John T.
Leonard A.

# State of New York,
## Court of Appeals

*At a session of the Court, held at Court of Appeals Hall in the City of Albany on the* fifteenth *day of* September *A. D. 19* 83

**Present,** HON. LAWRENCE H. COOKE, *Chief Judge, presiding*

3 Mo. No. 735
In the Matter of Top Tile Building Supply Corp., Top Carpet Corp., Norman L. Stone, Richard Stone, Appellants,
vs.
New York State Tax Commission, et al., Respondents,
For a Judgment &c.

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A motion having heretofore been made herein upon the part of the respondents to dismiss the appeal taken by the appellants in the above cause to this Court and papers having been submitted thereon and due deliberation having been thereupon had, it is

ORDERED, that the said motion be and the same hereby is granted and the appeal dismissed, with costs and twenty dollars costs of motion, upon the ground that the appellants are not aggrieved by the modification at the Appellate Division (CPLR 5601[a][iii]), and that no substantial constitutional question is directly involved.

Joseph W. Bellacosa
Clerk of the Court

STATE OF NEW YORK

STATE TAX COMMISSION

| | |
|---|---|
| In the Matter of the Petition<br>of<br>TOP TILE BUILDING SUPPLY CORP. and NORMAN L. STONE and RICHARD STONE, Individually and as Officers<br>for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1967 through February 28, 1974. | DECISION |
| In the Matter of the Petition<br>of<br>TOP CARPET CORP. and NORMAN L. STONE and RICHARD STONE, Individually and as Officers<br>for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1967 through May 31, 1973. | |

Petitioners, Top Tile Building Supply Corp., Top Carpet Corp. and Norman L. Stone and Richard Stone, Individually and as Officers, 237 Mamaroneck Avenue, White Plains, New York 10605, filed petitions for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law. Top Tile Building Supply Corp. filed a petition for the period December 1, 1967 through February 28, 1974 (File No. 14362). Top Carpet Corp. filed a petition for the period December 1, 1967 through May 31, 1973 (File No. 14361).

A formal hearing was held before William J. Dean, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 31, 1979 at 1:15 P.M. and was continued on January 31, 1980,

and on February 1, 1980. Petitioners appeared by Lorentz W. Hanson, Esq. The Audit Division appeared by Ralph J. Vecchio, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUES

I. Whether the assessments against petitioners are barred by the period of limitations provided for in section 1147(b) of the Tax Law.

II. Whether the field audit properly determined the sales tax due.

III. Whether Norman L. Stone and Richard Stone are personally liable for any taxes due pursuant to section 1131 of the Tax Law.

FINDINGS OF FACT

1. On November 8, 1973, the Audit Division, on the basis of an estimate, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Top Tile Building Supply Corp. ("Top Tile"), for taxes due of $82,985.77, plus penalty and interest of $30,596.35, for a total of $113,582.12. On April 2, 1976, the Audit Division issued an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due against Top Tile for taxes due of $24,520.02, plus penalty and interest of $19,717.47, for a total of $44,237.49. The notice dated April 2, 1976 was in addition to, and did not supersede, the notice dated November 8, 1973.

2. At the hearing it was stipulated that, with regard to Top Tile, the amount of tax at issue was $64,697.37.

3. On November 20, 1973, the Audit Division, on the basis of an estimate, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Top Carpet Corp. ("Top Carpet"), for taxes due of $13,262.09, plus penalty and interest of $4,373.11, for a total of $17,635.20. On April 2, 1976, the Audit Division issued an additional Notice of Determination

and Demand for Payment of Sales and Use Taxes Due against Top Carpet for taxes due of $3,011.72, plus penalty and interest of $1,825.04, for a total of $4,836.76. The notice dated April 2, 1976 was in addition to, and did not supersede, the notice dated November 20, 1973.

4. At the hearing it was stipulated that, with regard to Top Carpet, the amount of tax at issue was $7,775.43.

5. The audit of Top Tile and Top Carpet was originally assigned to the New York City District Office in 1970 where the offices of both petitioner corporations were located. The corporate offices were moved to White Plains and the corporations changed the location where their records were stored several times during 1971 through 1973. As a result, the audit was reassigned but never completed.

On October 26, 1973, the audit was assigned to Frances Schaeffer, an auditor in the White Plains District Office. She made an initial appointment with the vendors' accountant which was subsequently cancelled. At that time, the auditor mailed to Norman L. Stone, President of Top Tile, consents extending the period of limitations for both Top Tile and Top Carpet. The consents, dated October 29, 1973, were executed by Norman L. Stone and received by the White Plains District Office on November 5, 1973. Both consents extended the periods of limitation until December 20, 1974. Each corporation had previously submitted consents extending the periods of limitation in January 1971, October 1971, and November 1972.

Mrs. Schaeffer was of the opinion that the repeated transfer of the records indicated that the vendors were avoiding an audit. She discussed the matter with her supervisor and at his direction prepared estimated assessments against both corporations increasing reported sales by 20 percent.

6. In February, 1974, the audit was assigned to auditor Donald Bryant of the Albany District Office. Mr. Bryant began his examination on October 28, 1974, and submitted his reports on November 5, 1975. The audit procedures used were as follows:

(a) The first phase of the audit of Top Tile involved the selection of two (2) one-week test periods, February 1-6, 1969 and September 1-7, 1971. A one-week test period, September 1-7, 1971, was selected for Top Carpet. The sales records of each corporation were examined and it was determined that both Top Tile and Top Carpet owed additional sales tax for the test period in the amounts of $129.57 and $36.10 respectively. The result of the test period audits were used to calculate error ratios in the petitioner's reporting of sales tax. These error ratios were then projected over the full periods covered by the audits.

(b) In addition to using these test periods to calculate uncollected taxes, the auditor examined petitioners' daily sales sheets to determine unreported taxes. From these sheets the sales tax actually collected during the entire audit period was compared to the sales tax reported. It was determined that Top Tile had failed to report $31,951.45 in sales tax it had collected and Top Carpet had failed to report $2,625.69 in sales tax it had collected.

7. While the audits were being conducted, petitioners made their records available to Mr. Bryant. These included original sales invoices, original purchase invoices, purchase journals, ledgers, and daily cash sheets. Because the audit covered an extended period and involved records of numerous stores, the documents made available to the auditor were voluminous.

8. Top Carpet was formed for the benefit of former employees of Top Tile. No shares of Top Carpet stock were given to Norman L. Stone or to Richard

Stone. Top Tile provided bookkeeping and sales tax preparation assistance to Top Carpet. Neither Norman L. Stone nor Richard Stone were officers of Top Carpet.

9. Norman L. Stone was president of Top Tile and Richard Stone was treasurer of Top Tile. Both had major responsibility for the management and affairs of Top Tile.

CONCLUSIONS OF LAW

A. That the consent extending the period of limitations executed by Norman Stone on behalf of Top Tile in November of 1973 was valid since he was an officer of that corporation and as such was authorized to sign such a consent. Therefore, no portion of the assessment included in the Notice of Determination issued to Top Tile was barred by the period of limitations provided by section 1147(b) of the Tax Law. However, the consent extending the period of limitation executed by Norman Stone on behalf of Top Carpet was invalid since he was neither an officer nor was he a person authorized by that corporation to sign such a consent.

B. That the Audit Division was justified in issuing estimated assessments against Top Tile and Top Carpet in November, 1973, since petitioners had repeatedly delayed in making their books and records available.

C. That section 1147(b) of the Tax Law provides that "no assessment of additional tax shall be made after the expiration of more than three years from the date of the filing of a return". Since the Notice of Determination was issued against Top Carpet on November 20, 1973 and since no valid consents extending the period of limitations were executed, that portion of the assessment against Top Carpet relating to taxable quarters prior to September 1, 1970, must be cancelled.

D. That "Although there is statutory authority for the use of a 'test period' to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law, §1138, subd. [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit...However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack of rational basis." Chartair, Inc. v. State Tax Commission, 411 N.Y.S.2d 41; therefore, the Audit Division was not justified in using the "test period" audit procedures described in Finding of Fact "6(a)" since petitioners had, by the time of the actual audits, made their books and records available to the auditor and these records were sufficient for determining the exact amount of tax due. Since these records were made available, only those portions of the assessments against Top Tile and Top Carpet which were based directly upon petitioners' records can be sustained. Those portions include the actual sales tax found to be due during the one and two week test periods of Top Carpet and Top Tile, and also the amounts of unreported sales tax as were discovered by the audit procedures described in Finding of Fact "6(b)".

E. That Norman L. Stone and Richard Stone were persons required to collect tax for Top Tile with respect to section 1131 of the Tax Law. Norman L. Stone served as President of Top Tile and Richard Stone as Treasurer. Both had major responsibility for the management and affairs of Top Tile.

F. That Norman L. Stone and Richard Stone were not persons required to collect tax for Top Carpet with respect to section 1131 of the Tax Law. Neither Norman L. Stone nor Richard Stone served as an officer of Top Carpet

C. That the petitions of Top Tile Building Supply Corp., Top Carpet Corp. and Norman L. Stone and Richard Stone, individually and as officers, are granted to the extent indicated in Conclusions of Law "C", "D" and "F"; that the Audit Division is directed to modify the notices of determination issued on November 8, 1973, November 20, 1973 and April 2, 1976; and that, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York
OCT 23 1981

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER

SUPREME COURT - COUNTY OF ALBANY

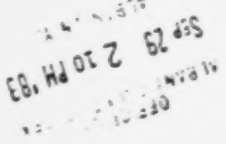
In the Matter of TOP TILE BUILDING SUPPLY CORPORATION, TOP CARPET CORPORATION, NORMAN L. STONE and RICHARD STONE,
Appellants,
-against-
NEW YORK STATE TAX COMMISSION; NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES H. TULLY, JR., MILTON KOERNER, THOMAS H. LYNCH, individually and as members of the State Tax Commission,
Respondents.

JUDGMENT

INDEX NO. 3381-82

Top Tile Building Supply Corporation, Top Carpet Corporation, Norman L. Stone and Richard Stone, the Appellants herein represented by Lorentz W. Hansen, Esq., 175 Main Street, White Plains, New York 10601, having taken an appeal to the Court of Appeals from an order of the Appellate Division of the Supreme Court, Third Judicial Department, entered in the office of the Clerk of said Appellate Division on the 13th day of May, 1983, and the Court of Appeals, after due deliberation, having rendered a decision on the 15th day of September, 1983, granting the Notice of Motion to Dismiss the appeal made by the appellants, ordering that the said motion to dismiss be and the same hereby is granted, with costs and twenty dollars costs of motion, and an order having been entered so affirming it is hereby:

ADJUDGED, that the aforesaid motion be, and the same hereby is denied, with costs of $85.00 to Respondents the New York State Tax Commission, the New York State Department of Taxation and Finance; James H. Tully, Jr., Milton Koerner, Thomas H. Lynch, individually and as members of the State Tax Commission, Executive Bureau, State



Campus, Tax and Finance Building, Albany, New York 12227, and that the Respondents have execution thereon.

Guy D. Paquin
Clerk

DATED AND ENTERED: Sept 29 1983

STATE OF NEW YORK
COUNTY OF ALBANY CLERK'S OFFICE } ss.:

I, GUY D. PAQUIN, Clerk of the said County, and also Clerk of the Supreme and County Courts, being Courts of Record held therein, DO HEREBY CERTIFY that I have compared the annexed copy Judgment with the original thereof filed in this office on the 29 day of Sept. 1983 and that the same is a correct transcript therefrom, and of the whole of said original.

IN TESTIMONY WHEREOF, I have hereunto set my name and affixed my official seal, this 29 day of Sept. 1983

Guy D. Paquin Clerk

State of New York
Supreme Court - County of Albany

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In the Matter of TOP TILE BUILDING SUPPLY CORP., TOP CARPET CORP., NORMAN L. STONE, RICHARD STONE,

Petitioners-Appellants,

-against-

INDEX NO. 3381-82

NEW YORK STATE TAX COMMISSION; NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES H. TULLY, JR., MILTON KOERNER, THOMAS H. LYNCH, Individually and as Commissioners of the State Tax Commission,

NOTICE OF APPEAL

Respondents-Respondents.

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules.

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Sirs:

PLEASE TAKE NOTICE that the above named petitioners, Top Tile Building Supply Corp., Top Carpet Corp., Norman L. Stone and Richard Stone hereby appeal to the Supreme Court of the United States from the judgment in the above-captioned matter entered in the Supreme Court, County of Albany, State of New York on the 29th day of September, 1983, pursuant to an order of the New York Court of Appeals dismissing the petitibners appeal to that court, and from each and every part of the aforesaid judgment. Said appeal is taken pursuant to Title 28 United States Code. Section 1257(2).

Yours, etc.

Lorentz W. Hansen

cc. Attorney General, State of New York
c/o Francis V. Dow
Assistant Attorney General
Department of Law
Albany, N.Y. 12224

Certificate of Attorney
Filed: Supreme Court
Albany County, New York
and Appellate Division
Third Department
December 23, 1983

Lorentz W. Hansen, Esq.